No. — 74 ~~705~~

In the Supreme Court of the United States

OCTOBER TERM, 1954

UNITED STATES OF AMERICA, PETITIONER

v.

LESLIE SALT CO.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

The District Court's opinion (R. 18-20) is reported at 110 F. Supp. 680. Its findings of fact and conclusions of law (R. 29-33) are not reported. The opinion of the Court of Appeals (Appendix, *infra*, pp. 1a-3a) is reported at 218 F. 2d 91.

JURISDICTION

The judgment of the Court of Appeals (Appendix, *infra*, p. 3a) was entered on December 16,

1954. By order of Mr. Justice Douglas, dated March 3, 1955, the time for filing a petition for a writ of certiorari was extended to and including May 14, 1955 (Appendix, *infra*, p. 4a). The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTION PRESENTED

The taxpayer borrowed $4,000,000 from two insurance companies under identical loan agreements which provided for repayment over a period of fifteen years, imposed extensive conditions and limitations upon the borrower, and granted other privileges and benefits to the lenders for the protection of their investments. The question presented is whether such instruments are subject to the documentary stamp tax imposed by Sections 1800 and 1801 of the Internal Revenue Code of 1939 on "all bonds, debentures, or certificates of indebtedness issued by any corporation * * *."

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

SEC. 1800. IMPOSITION OF TAX:

> There shall be levied, collected, and paid, for and in respect of the several bonds, debentures, or certificates of stock and of indebtedness, and other documents, instruments, matters, and things mentioned and described in sections 1801 to 1807, inclusive, or for or in respect of the vellum, parchment, or paper upon which such instruments, matters, or things, or any of

them, are written or printed, the several taxes specified in such sections.

(26 U.S.C. 1952 ed., Sec. 1800.)

Sec. 1801 [As amended by Section 1 of the Revenue Act of 1939, c. 247, 53 Stat. 862; Section 209 of the Revenue Act of 1940, c. 419, 54 Stat. 516; and Section 521(a)(3) of the Revenue Act of 1941, c. 412, 55 Stat. 687]. CORPORATE SECURITIES.

On all bonds, debentures, or certificates of indebtedness issued by any corporation, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities, on each $100 of face value or fraction thereof, 11 cents * * *.

(26 U.S.C. 1952 ed., Sec. 1801.)

Treasury Regulations 71 (1941 ed.):

Sec. 113.50. *Scope of Tax.*—Section 1801 imposes a tax upon the issue by any corporation of bonds, debentures, certificates of indebtedness, and all instruments, however termed, with interest coupons or in registered form and known generally as corporate securities. Every renewal of the above described instruments is taxable as a new issue.

* * * * *

Sec. 113.55. *Issues Subject to Tax.*—Ordinarily, a corporate instrument styled a bond, debenture, or certificate of indebtedness is subject to the tax. However, the taxability of an

instrument is not determined by the name alone but depends upon all the circumstances, such as the name, form, and terms of the instrument, etc. Hence, an instrument, however designated, having all the essential characteristics of a bond, debenture, or certificate of indebtedness is taxable as such. Similarly, an instrument issued with interest coupons, or with provision for registration, and coming within the class known generally as corporate securities will be held subject to the tax, regardless of the name by which it may be called.

STATEMENT

In 1948, the Leslie Salt Company, a California corporation (the taxpayer), owed approximately $2,000,000 to certain banks. (R. 46-47.) In order to fund, extend, and increase the amount of the loans, and to obtain needed working capital, it negotiated a $4,000,000, 15-year loan from Pacific Mutual Life Insurance Company and Mutual Life Insurance Company of New York, Pacific Mutual furnishing $1,000,000 and Mutual of New York contributing $3,000,000, pursuant to separate but identical loan agreements (R. 18, 45, 85, 93-133) executed under date of February 1, 1949. To evidence this loan the taxpayer executed two instruments, also dated February 1, 1949,[1] identical ex-

[1] Under date of February 15, 1949, the closing date under the agreement, the taxpayer also executed a separate "Certificate" pursuant to each loan agreement (R. 44, 45, 85, 90-93) purporting to certify that there had been no adverse changes in its condition since execution of the agreement.

cept for amount and name of payee (R. 44, 45, 85, 87-89), denominated "3¼% Sinking Fund Promissory Note Due February 1, 1964," in which, for value received, the taxpayer promised to pay to the payee named therein, on February 1, 1964, the principal amount, and to pay on August 1 and February 1 in each year interest at the rate of 3¼% per annum on the unpaid balance. Each note recited that it was one of one or more such notes, each of the denomination of $1,000 or a multiple thereof, made or to be made by the taxpayer in an aggregate principal amount of $4,000,000, all maturing on February 1, 1964, and bearing interest payable at the same rate and on the same dates. The note also provided that the holder, at his option, might surrender it for exchange at the office of the taxpayer and without expense receive therefor a note or notes in authorized denomination, dated as of the date to which interest had been paid on the original note.

Each payment in reduction of principal was to be recorded on the note, and it was further specified that (R. 88-89)—

> This Note is issued under and is entitled to the benefits of the provisions of an Agreement of the Company dated February 1, 1949, with respect to the Notes, a copy of such Agreement being on file at the principal office of the Company. As provided in said agreement the Notes may be prepaid prior to maturity at the option of the Company. As further provided in said agreement, the Notes are en-

titled to the benefits of the sinking fund provided for therein and are subject to prepayment through the operation of such sinking fund. In case an Event of Default, as defined in said agreement, has occurred, the principal of the Notes may be declared or may become due and payable in the manner, at the time, and with the effect provided in said Agreement.

The two separate but identical loan agreements, dated February 1, 1949, are lengthy and detailed instruments, one of which is reprinted at pages 93-133 of the printed record. In summary, by Section 1 of the agreement (R. 93-94) the taxpayer agreed to authorize the issue of two promissory notes in the aggregate principal amount of $4,000,000, to bear interest at 3¼%, to be dated February 1, 1949, and to mature February 1, 1964. Subject to the terms and conditions of the agreement, the taxpayer agreed to "sell," and the insurance companies agreed to "purchase" from the taxpayer as of the "closing date," a note in the principal amount at a "purchase price" equal to 100 per cent of the principal amount plus interest from February 1, 1949, to the closing date, delivery to be made at the taxpayer's San Francisco office upon payment of the purchase price. Section 2 (R. 95-96) recorded delivery to the lender of taxpayer's balance sheets for 1944-1948 and other materials describing taxpayer's business and properties, and contained representations by the tax-

payer as to its past earnings and financial condition. Section 3 (R. 96-100) enumerates the conditions under which the lenders agreed to "purchase" the notes, the more important of which were (1) that the lenders should receive the opinion of legal counsel that the transaction was exempt under the Securities Act of 1933, c. 38, 48 Stat. 74 (15 U.S.C. 1952 ed., Sec. 77a, *et seq.*); (2) that it was not necessary in connection with such purchase to qualify an indenture under the Trust Indenture Act of 1939, c. 411, 53 Stat. 1149 (15 U.S.C. 1952 ed., Sec. 77aaa, *et seq.*); and (3) that since the purchaser was acquiring the note for investment and not with a view to distribution, if in the future the purchaser should deem it expedient to sell the note or any notes which might be issued in exchange therefor, such sale would be an exempt transaction under the Securities Act of 1933, as amended, and would not of itself require registration of the note or such new notes, although such registration would be required as a condition of any distribution by underwriters, as defined in that Act, if at the time of sale the lender controlled the taxpayer.

Section 4 (R. 100-102) stated that the agreement was made on the representation of the purchaser that it was acquiring the note for its own account, and not with a view to, or for sale in connection with, the distribution thereof. However, recognizing the unqualified right of the purchaser to dispose of its property, the section further provided that so long as the purchaser held a note or notes

of the aggregate principal amount of $300,000 or more the taxpayer would, upon receipt of written request, execute and deliver at its own expense a trust indenture providing for the issue thereunder of new 3¼% Sinking Fund Notes of the taxpayer dated February 1, 1964, limited to the principal amount of notes unpaid at the date of execution of the agreement, bearing interest at the rate and entitled to the substantive benefits of the original notes. The taxpayer agreed, upon execution of such a new indenture, to issue new notes of the same or a different authorized denomination or denominations ($1,000 or a multiple thereof) either in registered form without coupons or in coupon form, and in printed or in fully engraved form, at the request of the lender, and bearing interest from the date to which interest had been paid on the surrendered note or notes, the taxpayer to bear all expenses in connection therewith, including "all stamp and other taxes" except transfer taxes.

Section 5 of the loan agreement (R. 102-105) contains the sinking fund and prepayment provisions. By paragraph 1 of that section the taxpayer is required to make "Fixed Sinking Fund Payments" annually, beginning February 1, 1951, in the amount of $285,000, without premium. Paragraph 2 provides that on each Fixed Sinking Fund Payment date the taxpayer, at its option and upon giving prior written notice, "may call for prepayment," without premium, a further principal amount of the notes equal to $285,000, provided such payment is made from earnings or

proceeds of liquidation of assets, and not from other sources. Paragraph 3 provides for "Optional Prepayments" upon written notice by the taxpayer not less than 30 days or more than 60 days prior to the date of such prepayment, either of the entire unpaid balance of principal or any part thereof not less than $50,000, with interest to the date of prepayment, plus graduated premium ranging from 3%, if prepaid in the 12 months period ending January 31, 1950, to ¼% if prepaid in the 12 months period ending January 31, 1963, and none if prepaid in the 12 months period ending January 31, 1964. Notation is to be made on the notes of any payment made in reduction of principal. (Par. 5.) All such payments of principal are to be allocated among the several noteholders, if more than one, in proportion to the amounts held by them. (Par. 6.)

By Section 6 of the loan agreement (R. 105-110) the taxpayer covenants that so long as any note or notes issued thereunder are outstanding the taxpayer and its subsidiaries will promptly pay all taxes, assessments, governmental charges, etc.; will keep their respective properties in good repair, working order and condition, and make all needed and proper renewals, replacements, extensions, betterments and improvements for the advantageous conduct of their business; will keep full and accurate business records; will reflect in their financial statements proper reserves for depreciation, depletion, obsolescence, accruals for federal and all other taxes, and all other appropriations to re-

serves which should be made in accordance with sound accounting practices; will keep all of their plants, properties, and inventories of an insurable character adequately insured; and furnish all financial statements and compliance certificates as therein provided.

By Section 7 of the loan agreement (R. 110-121) the taxpayer agrees in detail for itself and its subsidiaries that they will not create, assume, or incur in any manner any additional indebtedness except as necessary in the ordinary conduct of their business; will not mortgage, encumber, or dispose of any of their properties without adequate consideration; will not declare dividends or make distributions, with certain exceptions which would not affect the security of the loan; will maintain a net working capital at all times of at least $1,000,000; will not assume any secondary liability by guarantee or otherwise; and will limit investments, loans, and advances to the extent specified. Section 8 (R. 121-126) defines certain terms used in the loan agreement, and Section 9 (R. 126-128) enumerates the events which would amount to a default on the part of the taxpayer and make the unpaid balance of the loan immediately due and payable.

The Commissioner of Internal Revenue assessed a documentary stamp tax against the taxpayer in the amount of $4,400 pursuant to Sections 1800 and 1801 of the Internal Revenue Code of 1939 (*supra*, pp. 2-3) with respect to its issuance of the above-described notes. The tax was paid under protest

and the taxpayer filed a timely refund claim. (R. 41-42.) The Commissioner rejected the refund claim (R. 134-137) on the ground that by their terms the instruments here involved represented a method of financing similar to that accomplished through the medium of a public issuance of investment securities under an indenture; that the instruments were issued by the taxpayer as a corporate borrower to obtain money for use in its business under conditions similar to the sale of bonds, debentures, or other investment securities; that the fact the borrowing was effected through one or more lenders, rather than the general public, was immaterial to the question at issue; and that, considering all the circumstances, the instruments in question were "debentures" within the stamp tax provisions. The District Court (R. 18-20, 29-33) held that the instruments were not subject to the documentary stamp tax, and the Court of Appeals affirmed (Appendix, *infra*, pp. 1a-4a).

REASONS FOR GRANTING THE WRIT

The problem of determining the nature of the "debentures" subject to the stamp tax provisions here involved has led to a series of diverse and conflicting decisions in the lower courts. We believe that long-term instruments of the type in this case, imposing elaborately detailed restrictions on the borrower and effecting in practical economic terms the kind of capital financing traditionally achieved through the issuance of debentures, are squarely within the class to which the stamp tax applies.

We submit, in any event, that with over a hundred cases pending, with many more to be anticipated from rejection of current refund claims, and in view of the increasing prevalence of financing by means of arrangements like those presented here, the problem is one which should be resolved by this Court.

1. The stamp tax in issue is imposed by Sections 1800 and 1801 of the Internal Revenue Code of 1939 (*supra*, pp. 2-3) upon "all bonds, debentures, or certificates of indebtedness issued by any corporation * * *." As originally enacted in the Act of October 22, 1914, c. 331, 38 Stat. 745 (Section 5, p. 753, and Schedule A, p. 759), this statute also levied a tax upon "promissory notes" (38 Stat. at 760). But "promissory notes" were eliminated by the Revenue Act of 1924, c. 234, 43 Stat. 253, 333, Schedule A of Title VIII.[2] And so in the instant case, as in a host of similar cases, the question has been put in terms of whether instruments evidencing long-term loans of large amounts, under agreements imposing extensive restrictions upon the borrower for the lender's protection, are "promissory notes" (exempt from the stamp tax) or "debentures" (subject to the tax).

The decisions, as the court below observed (Ap-

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[2] The history of the Code provisions here involved is reviewed in the majority opinion of Judge Harlan in *Niles-Bement-Pond Co.* v. *Fitzpatrick*, 213 F. 2d 305 (C.A. 2). See, also, *General Motors Acceptance Corp.* v. *Higgins*, 161 F. 2d 593, 595 (C.A. 2), certiorari denied, 332 U.S. 810; *Stuyvesant Town Corp.* v. *United States*, 111 F. Supp. 243, 246-247 (C. Cls.), certiorari denied, 346 U.S. 864.

pendix, *infra*, p. 3a), have headed "in all directions." To select only two from the considerable number of divergent results in the lower courts, there is a square conflict between the instant decision and *Commercial Credit Co. v. Hofferbert*, 188 F. 2d 574 (C.A. 4), affirming *per curiam* 93 F. Supp. 562 (D. Md.). The undisputed facts in these two cases are the same in all material respects. In both, the instruments in question evidenced large long-term loans from insurance companies and were called "notes." The instruments in each case referred specifically to a contemporaneous agreement imposing restrictions and limitations upon the borrower for the protection of the lender. In both cases the lender could require issuance of the borrower's obligations in smaller denominations subject to substantially the same terms as those contained in the original agreement. See 93 F. Supp. at 562-563; *supra*, pp. 5-10. Contrary to the decision below, the courts in the *Commercial Credit* case concluded that there was "no difficulty in finding that the note read in connection with the Agreement * * * constituted a corporate debenture of the Commercial Credit Company." *Id.* at 565, affirmed on the district court opinion, 188 F. 2d 574.

Other decisions bear out the observation of the court below (Appendix, *infra*, p. 2a) that the contrariety of results reflects reliance upon distinctions which make no real difference. Compare, for example, the majority and dissenting opinions in *Niles-Bement-Pond v. Fitzpatrick*, 213 F. 2d 305

(C.A. 2). There the majority, reversing the district court and holding the instruments in question non-taxable, distinguished its earlier decision in *General Motors Acceptance Corp.* v. *Higgins*, 161 F. 2d 593, certiorari denied, 332 U.S. 810, as well as *Commercial Credit Co.* v. *Hofferbert*, *supra*, largely on the ground that the lender was a bank rather than an insurance company.[3] Rejected by the court below in the instant case,[4] that distinction was criticized in the dissent of Judge Clark as emphasizing the character of the lender rather than the needs of the borrower and the nature and purposes of the loan. The criticism is, in our view, justified. More importantly, it reflects the need for authoritative guidance which makes review by this Court necessary and appropriate.

We had supposed earlier that the varying decisions in this area could somehow be reconciled in terms of variations in the factual composites they presented. On this view, we refrained from

[3] See also *Curtis Publishing Co.* v. *Smith*, 124 F. Supp. 508, 513 (E.D. Pa.), affirmed, April 25, 1955 (C.A. 3, No. 11,504), 1955 P-H Vol. 4, ¶ 72,636; cf. *United States* v. *General Shoe Corp.*, 117 F. Supp. 668 (M.D. Tenn.), pending on taxpayer's appeal to the Sixth Circuit; *S. S. Pierce Co.* v. *United States*, 127 F. Supp. 396 (D. Mass.), pending on taxpayer's appeal to the First Circuit. And compare *Sharon Steel Corp.* v. *United States*, 1955 CCH, ¶ 49,107 (W.D. Pa.) (instrument evidencing loan from insurance company a taxable "debenture"), with *Follansbee Steel Corp.* v. *United States*, 1955 CCH, ¶ 49,108 (W.D. Pa.) (instrument evidencing bank loan non-taxable "promissory note"), both decided by District Judge Willson on March 22, 1955.

[4] As we have noted, the lenders here were insurance companies, a fact which, if it were material, would assimilate this case to *General Motors Acceptance* rather than *Niles-Bement-Pond*.

seeking certiorari in such cases as *Belden Mfg. Co. v. Jarecki*, 192 F. 2d 211 (C.A. 7); *United States v. Ely & Walker Dry Goods Co.*, 201 F. 2d 584 (C.A. 8); *Allen v. Atlanta Metallic Casket Co.*, 197 F. 2d 460 (C.A. 5); and *Niles-Bement-Pond v. Fitzpatrick*, *supra*; and we opposed certiorari in *Stuyvesant Town Corp. v. United States*, 111 F. Supp. 243 (C. Cls.), certiorari denied, 346 U.S. 864. It has become apparent, however, that the differences between the decisions upholding the stamp tax[5] and those denying its application[6] are differences as to the legal definition of "debentures" and "certificates of indebtedness" as these terms are used in the stamp tax statute. We now believe that the importance of the problem (see p. 18, *infra*) warrants this Court's intervention.

2. It is the position of the Government that instruments evidencing long-term loans which contain, directly or by reference to a contemporaneous agreement, detailed restrictions on the borrower for the lender's benefit come within the statute as "debentures" or "certificates of indebtedness." This view, we think, takes proper

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[5] *General Motors Acceptance Corp. v. Higgins*, *supra*; *Commercial Credit Co. v. Hofferbert*, *supra*; *Gamble-Skogmo, Inc. v. Kelm*, 112 F. Supp. 872 (D. Minn.); *Kobacker & Sons Co. v. United States*, 124 F. Supp. 211 (N.D. Ohio); *United States v. General Shoe Corp.*, *supra*; *S. S. Pierce Co. v. United States*, *supra*; *Stuyvesant Town Corp. v. United States*, *supra*.

[6] *Niles-Bement-Pond Co. v. Fitzpatrick*, *supra*; *Belden Mfg. Co. v. Jarecki*, *supra*; *United States v. Ely & Walker Dry Goods Co.*, *supra*; *Allen v. Atlanta Metallic Casket Co.*, *supra*; *Shamrock Oil & Gas Co. v. Campbell*, 107 F. Supp. 764 (N.D. Texas); *Curtis Publishing Co. v. Smith*, *supra*.

account of the fact that this type of instrument has become an increasingly familiar device for the long-term capital financing of corporations.[7] Indeed, it was already true at the turn of the century that the practice of printing the entire loan agreement as part of the debenture itself had been largely abandoned in favor of issuing a shorter form of debenture and incorporating by reference the terms of the contemporaneous agreement under which the loan was made.[8] This development had preceded the enactment of the stamp tax statute in 1914 and, of course, the elimination of "promissory notes" in 1924. *Supra*, p. 12.

Neither the statute nor the Treasury Regulations issued thereunder have attempted to define the term "debentures" as used in the statute, but it is clear from dictionary definitions and textbook discussion that the term includes instruments

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[7] See *Commercial Credit Co.* v. *Hofferbert*, *supra*; 2 Dewing, *Financial Policy of Corporations*, p. 1107 (5th ed. 1953), and citations in footnote 5; Jacoby & Saulnier, *Business Finance & Banking*, p. 104 (1947); American Institute of Banking, *Credit Administration*, pp. 324-325 (1949); Prochnow, *Term Loans and Theories of Bank Liquidity*, pp. 22, 141-147 (1949); House Hearings Before a Subcommittee of the Committee on Interstate and Foreign Commerce, Part 2, 82d Cong., 2d Sess., May 20 and 21, 1952; Securities & Exchange Commission, *Privately Placed Securities—Cost of Flotation* (published under date of September 2, 1952, Government Printing Office, Washington, D. C.); Holthausen, *Term Lending to Business by Commercial Banks in 1946*, Federal Reserve Bulletin of May, 1947, p. 498; *Stamp Tax on Promissory Notes Representing Term Loans and Private Placements*, 54 Col. L. Rev. 428 (1954).

[8] See 1 Dewing, *Financial Policy of Corporations*, pp. 226, 228-230 (5th ed.; 1953).

evidencing long-term capital loans of the character here involved,[2] and that what was repealed in 1924 was the tax which covered notes used customarily in day to day commercial transactions of a short time credit character. See *General Motors Acceptance Corp.* v. *Higgins*, *supra*, p. 595; *S. S. Pierce Co.* v. *United States*, *supra*. The language of Section 1801 is as broad and all-inclusive as the language of Section 1802 of the 1939 Code imposing a documentary stamp tax on the issuance or transfer of shares of stock or other interests in a corporation, and of the latter section this Court said in *Raybestos-Manhattan Co.* v. *United States*, 296 U.S. 60, 63: "The reach of a taxing act whose purpose is as obvious as the present is not to be restricted by technical refinements." See also *Pennsylvania Co. for Insurances, Etc.* v. *Rothensies*, 146 F. 2d 148, 152 (C.A. 3); *Stuyvesant Town Corp.* v. *United States*, *supra*. Compare *Goodyear Co.* v. *United States*, 273 U.S. 100; *Founders General Co.* v. *Hoey*, 300 U.S. 268; *Motter* v. *Bankers Mortgage Co. of Topeka, Kan.*, 93 F. 2d 778, 779-780 (C.A. 8). Here, similarly, we submit, the purpose of Congress reaches corporate obligations like the ones in this case, elaborate instruments for long-range capital financing which are readily and

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[2] *See General Motors Acceptance Corp.* v. *Higgins*, *supra*, p. 596; *Commercial Credit Co.* v. *Hofferbert*, *supra*, p. 565; 6 *Encyclopaedia Brittanica*, p. 144 (1953); V *Encyclopaedia of the Social Sciences*, pp. 29-30 (1935 ed.); Hastings Lyon, *Corporations and Their Financing*, p. 242 (1938); 1 Dewing, *Financial Policy of Corporations*, pp. 226, 228-230 (5th ed., 1953); Mead, *Corporation Finance*, pp. 284-285 (5th ed., 1925).

appropriately described as "debentures" rather than mere "promissory notes."

3. The problem presented is an important one. The records of the Internal Revenue Service show that there are now 109 cases pending in the courts involving this issue; and that the total amount of taxes involved in these cases approximates $960,000. In addition, a survey has been made of nine District Directors' offices disclosing that in those offices alone there are 142 claims for refund involving this question which are being considered or have been rejected, and that these claims for refund involve taxes in excess of $1,700,000.

Moreover, the problem will continue under the Internal Revenue Code of 1954, in which both the statutory provisions and the legislative history evince a purpose to carry forward without change the pertinent portions of the 1939 Code. See Sections 4311-4315 and 4381 of the 1954 Code; H. Rep. No. 1337, 83d Cong., 2d Sess., p. A325; S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 482-483. Faced with the present contrariety of judicial opinion, the Internal Revenue Service lacks authoritative guidance in considering the host of claims already pending and others which will inevitably be filed. A ruling by this Court is needed to resolve this uncertainty.

CONCLUSION

It is respectfully submitted that this petition for a writ of certiorari should be granted.

SIMON E. SOBELOFF,
Solicitor General.

MAY, 1955.